

Information Item

Fiscal Policy and Analysis Committee

Highlights of Governor's Proposed 2002-03 State Budget

In this item, staff reviews both general fiscal information and specific education initiatives for the upcoming fiscal year. As proposed by Governor Davis, the State Budget for 2002-03 would increase the total State General Funds by only 0.5 % and addresses a \$12-billion-revenue shortfall by continuing spending restrictions already implemented, employing additional spending reductions, utilizing funding shifts and internal borrowing, and other strategies. Nevertheless, the governor's proposed budget for 2002-03 does provide for slight increases in funding to K-12 and higher education.

This report also discusses the State's longer-term fiscal prospects in light of both the proposed budget and economic forecasts that show currently that the California economy is not expected to produce revenues sufficient to sustain current State government expenditure levels and may not be so positioned until well into the 2003-04 budget period.

Presenter: Kevin G. Woolfork.



Highlights of the Governor's Proposed 2002-03 State Budget

THIS REPORT presents a preliminary analysis of the Governor's Budget proposed for the coming 2002-03 fiscal year. In addition to describing the budget process and providing background information on State finances, the report summarizes the governor's education budget for 2002-03 along with other fiscal information.

Background: the State Budget process

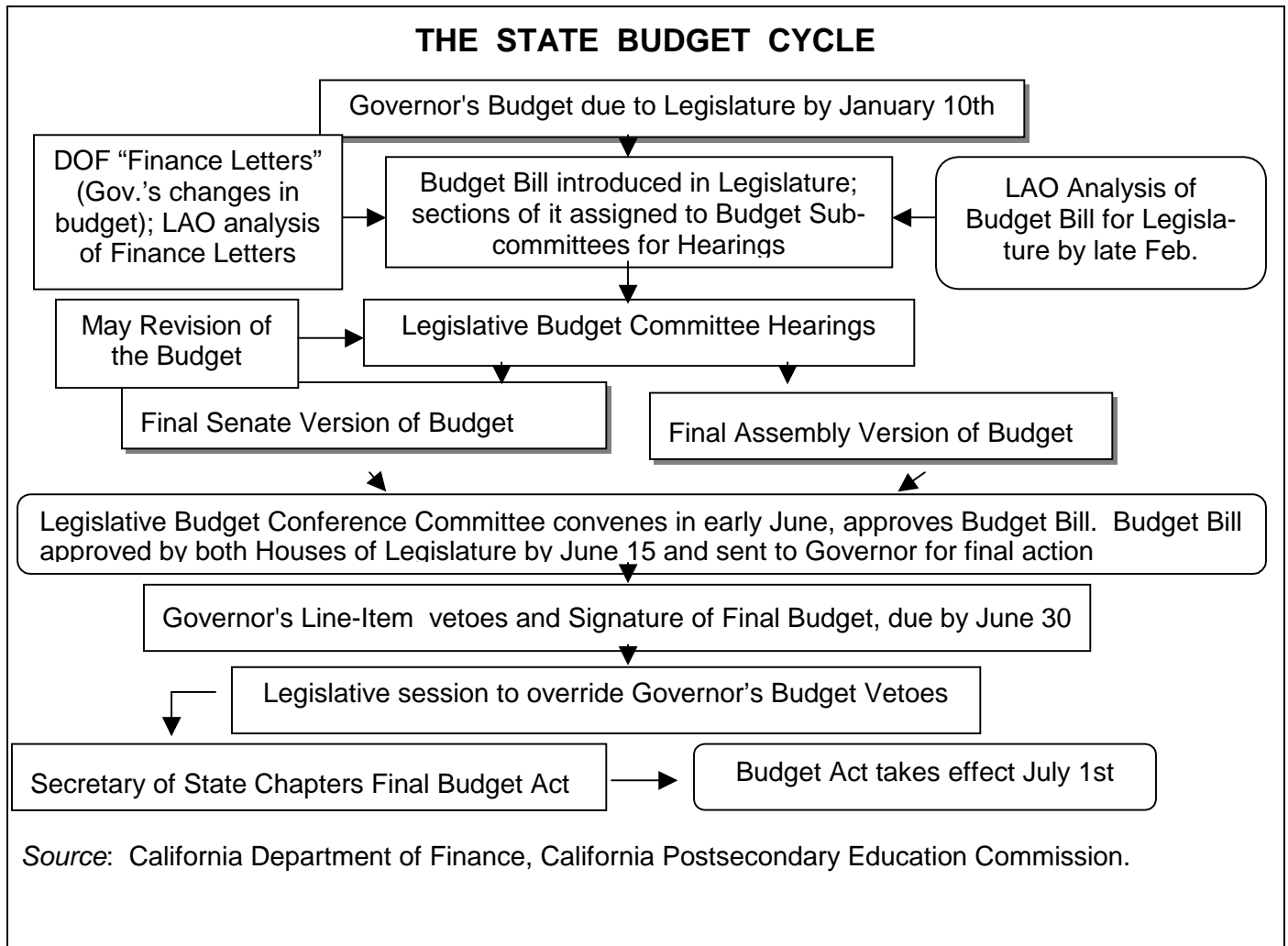
The annual Budget Act is the main source of funding for California government. Continuous statutory appropriations and special legislation also provide expenditure authority. The Director of Finance, the chief financial advisor to the governor, directs the effort for preparation of the Governor's Budget. By constitutional requirement, a Budget Bill itemizing recommended expenditures is introduced in each house of the Legislature, based upon the governor's January 10th budget proposal.

The Senate Budget and Fiscal Review Committee and the Assembly Budget Committee are the two legislative committees that hear the Budget Bills. The Legislative Analyst is charged by the Joint Legislative Budget Committee with providing analysis and recommendations for changes to the Governor's Budget plan and issues the annual "Analysis of the Budget Bill." The Budget Committees assign items in the bills to several "subject area" subcommittees (such as Education or Transportation). The subcommittees conduct hearings on budget items and related issues beginning in late February.

By statute, the Department of Finance is required to give the Legislature all proposed adjustments to the Governor's Budget, other than for capital construction, by April 1st; capital outlay budget adjustments are due by May 1st. In May, the governor releases a revision of the January budget proposal, based upon changes in State revenues, caseload estimates, and other information. This "May Revise" is released on May 14th and consists of an update of General Fund revenues, changes in school funding requirements pursuant to Proposition 98, and caseload, enrollment, and population-driven adjustments to budget items.

The Legislature awaits the May Revision before making final decisions on the State budget. The budget subcommittees present their reports to the full Budget Committees in each House by late May. The Assembly and Senate then reconcile their differences in a Legislative Budget Conference Committee. The State Constitution requires that the Legislature pass the Budget Bill by June 15th, and that the governor sign it by June

30th. The State fiscal year runs from July 1st through the following June 30th. The display below shows the State budget cycle as a flowchart. The California Postsecondary Education Commission is active in the State budget process, as related to education, throughout each stage of its development.



California's fiscal environment for the 2002-03 budget

Public revenues used to fund government programs and services for California residents are generated by the economic activity of the State and are captured through various taxes and user fees. For State government, primary among these sources are State Sales and Use taxes and State Income taxes, which are accounted for in the State General Fund. Local government mainly relies on State-allocated sales tax revenues and local property taxes.

In the 1999-2000 fiscal year, State General Fund revenues had increased 22 % over the prior year and in 2000-01 revenues grew another 8 % over 1999-2000. For the current 2001-02 fiscal year, the Legislative Analyst projects State General Fund revenues to decline by 12 % from last year.

This would represents the largest one-year drop in State General Fund revenues since the end of World War II. For the upcoming 2002-03 fiscal year, these revenues are anticipated to increase by 9 % above 2001-02's lower levels.

Economists had noted weakness in the California economy earlier this year, with decreases in personal income and taxable sales and increases in unemployment, with both trends accelerated by the September 11th terrorist attacks. The large, unanticipated increases in State revenues over the past three years had resulted chiefly from profits in high-tech areas of the economy and from personal wealth generated in securities markets. These sectors of the economy have both seen major declines over the past 12 months. The Legislative Analyst and the California Department of Finance both expect the current State and national recessions to be relatively short-lived, diminishing by the middle of 2002. Economists caution, however, that events could both lengthen California's current economic downturn. Nevertheless, recent economic indicators point to a strong recovery both in California and the nation by the end of this year.

**Governor's
proposed
2002-03 budget**

On Thursday, January 10, 2002, Governor Gray Davis released his proposed budget for the State of California for the 2002-03 fiscal year, which begins on July 1, 2002. The governor's proposed budget allocates more than \$100 million in combined General, Special, and Selected Bond funds to the many program and service areas. Total State General Fund spending will increase by \$426 million (0.5 %) to \$78.8 billion and for postsecondary education, State General funding will increase to \$10 billion in 2002-03 (0.5 %). Chart 1 below details proposed 2002-03 budget expenditures by fund source and Chart 2 shows estimates of revenue sources for the State General Fund and State Special Funds.

The proposed budget provides for a variety of remedies to address the States more than \$12-billion revenue shortfall. In November, 2001, the Governor froze current-year (2001-02) State General Fund expenditures at most agencies. The Department of Finance estimates that this measure saved the State \$2.2 billion for the current year. The 2002-03 Governor's Budget proposes additional budget-year spending reductions, funding shifts, internal borrowing, and other strategies to address this deficit. The governor estimates that the current year will end with a carryover of \$1.5 billion in General Funds and that the budget year will have an ending General Fund balance of just under \$2 billion.

For California education, the proposed 2002-03 Budget allocates more than \$41 billion in State General Funds, an increase of just \$321 million (0.8 %) to combined K-12 and Higher Education. However, when General Fund revenues are coupled with other sources such as local funds, student revenues, and other non-federal funds, education spending rises by \$1.5 billion (2.2 %) in 2002-03. Chart 3 below shows overall State and local funding for K-12 and higher education by system.

Chart 1: 2002-03 Governor's Budget Expenditures, by Fund Category (Dollars in Millions)

Expenditure Category	State General Fund	State Special Funds	Selected Bond Funds	Total
Health and Human Services	\$22,441	\$4,787	\$472	\$27,700
Youth and Adult Corrections	5,274	20	--	5,294
K-12 Education	31,316	4,787	--	36,103
Higher Education	9,985	745	648	11,378
Other Government Programs	9,790	13,498	993	24,281

Other Government Programs includes: "Business Transportation, Housing," "Technology, Trade, Commerce," "Courts," "Tax Relief," "Local Government Subventions," "Resources," "Environmental Protection," "State and Consumer Services," and other State programs and services

Source: California Department of Finance.

Chart 2: Estimates of Revenue Sources for the State General Fund and State Special Funds for the 2002-03 Governor's Budget (Dollars in Millions)

Revenue Source	State General Fund	State Special Funds
Personal Income Tax	\$42,605	--
Sale and Use Tax	22,850	2,531
Corporation Tax	5,869	--
Highway Users Taxes	--	3,244
Motor Vehicle Fees	16	3,915
Insurance Tax	1,656	--
Estate Tax	615	--
Liquor Tax	282	--
Tobacco Taxes	122	997
Other	5,290	4,841
Carryover Funds from Prior Year	<u>1,485</u>	<u>--</u>
Total	\$80,790	\$15,528

Source: California Department of Finance.

Chart 3: 2002-03 Governor's Budget Education Expenditures, by System (Dollars in Millions)

Education System	2001-02 (estimate)	2002-03 (proposed)	Dollar Change	Percent Change
K-12 Education	\$52,832	\$53,922	\$1,090	2.1%
California Community Colleges	6,194	6,298	\$104	1.7%
California State University	3,423	3,460	\$37	1.1%
University of California	4,440	4,486	\$46	1.0%
California Student Aid Commission	571	734	\$162	28.4%
Other Higher Education	241	274	\$34	14.0%

Other Higher Education includes: Hastings College of the Law, the California Postsecondary Education Commission, and General Obligation Bond Interest and Redemptions for UC, CSU, and Hastings.

Combined State, Local, Student Fee, and Lottery funding – "State Determined Funds" – are included here.

Source: California Department of Finance.

To meet the facilities needs of K-12 and public higher education, the 2002-03 budget proposes that three \$10 billion general obligation bond measure be placed before the voters in the November general elections of 2002, 2004 and 2006. The budget notes that Proposition 39, approved by the voters in November 2000, reduced the voter approval requirement for local school facilities bonds from a 67 %, two-thirds majority to a 55 % super-majority vote.

Since the passage of Proposition 39, Governor Davis notes that \$2.4 billion in local K-12 school bond funding has been approved by the voters. With this, the governor's \$30 billion obligation bond proposal includes a local match requirement for K-12 and community college districts. Each of these proposed bond measures are scheduled to provide \$8 billion in State funds, with a matching requirement for K-12 school facilities; \$2 billion in bond funds will be allocated for higher education facilities.

**Education system
funding summaries**

For K-12 Education, the proposed budget allocates a total of \$53.9 billion, not including Federal funds. This is an increase of \$1.1 billion (2.1 %) over current year funding levels. This level of funding would approximate to per-pupil spending of \$7,058 per K-12 student, which is an increase of \$136 per student over the current year. The proposed budget provides full statutorily required enrollment growth funds and cost-of-living adjustments for K-12 apportionment and categorical programs. The Budget proposes a total of nearly \$46 billion in Proposition 98 funding, of which K-12 education receives more than \$41 billion. This commitment meets (and possibly exceeds) the statutory funding requirements of Proposition 98 and allocates more than 42 % of State General Funds to the Proposition 98 funding guarantee.

The following program highlights for K-12 Education are adapted from the Governor's 2002-03 Budget Summary:

- ◆ \$400 million (including federal funds) for assistance to low-performing schools as measured by each school's "Academic Performance Index" (API). This program was approved for the current year but was delayed and the funding suspended due to fiscal constraints. The full augmentation of \$197 million is included in the Governor's proposed budget. Priority in funding will be provided to schools with the lowest API scores. Participating schools receive annual grants of up to \$400 per pupil to implement an action plan focusing on: pupil literacy and achievement; quality of staff; parental involvement; and facilities, curriculum, instructional materials, and support services.
- ◆ \$75 million expansion of the "Before and After School Learning and Safe Neighborhoods Partnerships Program," for a total of \$163 million. This program provides homework assistance, tutoring, and English language instruction before and after regular school hours. This increased amount includes \$30 million for expansion of grants that

were suspended in the current year and \$45.3 million for additional expansion, \$30 million of which reflects a shift of savings in other programs as a result of proposed changes to California's child care system.

- ◆ \$250 million in Proposition 98 funding for schools to purchase standards-aligned textbooks in the core curriculum areas for students in kindergarten and grades 1-12. Once schools have provided standards-aligned textbooks to each pupil, the remaining funds can be used for a variety of instructional materials purposes, including school library and K-4 classroom library materials. These funds will be allocated on a per-pupil enrollment basis.
- ◆ \$200 million in one-time Proposition 98 Reversion Account funding to purchase instructional materials for K-12 schools that certify they will purchase a basic Reading/Language Arts textbook for each pupil by the beginning of the 2002 school year. These funds will be allocated on a per-pupil enrollment basis.
- ◆ \$100 million in one-time Proposition 98 Reversion Account funding for school districts to purchase school library materials and K-4 classroom library materials. These funds will be allocated on a per-pupil enrollment basis.
- ◆ \$75 million in one-time Proposition 98 Reversion Account funding for the purchase of science laboratory equipment and materials to provide standards-based science instruction for grades 7-12.
- ◆ \$7.5 million for the second year of funding for the Principal Training Program, an Administration-sponsored program signed into law in 2001 designed to provide every principal and vice-principal in the state with training in instructional standards and effective school management techniques. The budget notes that the Gates Foundation has agreed to provide funds for the local match of \$1,000 for each principal and \$500 for each vice-principal.
- ◆ \$98.9 million for California Professional Development Institutes (PDI), which are now fully in place for reading, English language development for English learners, high school English, elementary mathematics, algebra, and high school mathematics. These Institutes are operated by the University of California at a variety of higher education institutions around the State.
- ◆ \$110 million for the Mathematics and Reading Professional Development Program, the intensive professional development program for teachers of math and reading launched by the Administration in 2001. This represents a \$30 million increase over the current-year funding level
- ◆ \$88.3 million for the Beginning Teacher Support and Assessment Program (BTSA), which will be sufficient to serve over 24,600 teach-

ers. This funding levels maintains the proposed \$20 million decrease in base funding proposed for 2001-02, but includes \$3.6 million for program growth and COLA.

For California postsecondary education, the governor's proposed budget allocates a total of \$15.2 billion, not including Federal funds for the California Community Colleges, the California State University, the University of California, and the other higher education institutions and agencies. This represents an increase of \$373 million (2.5 %) over current year funding levels. The budget funds enrollment growth estimates for the three public systems and provides funds for the students estimated to be eligible for Cal Grant awards in 2002-03

Higher education system funding highlights include the following, adapted from information provided by the Assembly Budget Subcommittee on Education Finance:

California Community Colleges

- ◆ Proposition 98 Split – The governor proposes to give the California Community Colleges 10.19 % of Proposition 98 funds, which is approximately the same as the amount they received in the current year.
- ◆ Enrollment Growth – \$118.7 million for a 3 % growth in enrollment for apportionments and categorical programs providing support for an additional 31,864 full-time equivalent students.
- ◆ COLA – \$88.8 million for a 2.1 % COLA to fund cost of living increases for both general-purpose funds and categorical programs.
- ◆ Instructional Materials/Scheduled Maintenance – \$98 million in funding for instructional materials (\$49 million) and scheduled maintenance (\$49 million), of which \$52.2 million comes from ongoing Proposition 98 funds and \$45.8 million from the Proposition 98 Reversion Account.
- ◆ Part-time Faculty – Maintains funding \$57 million for Part-time faculty compensation and \$7.2 million for the Part-time Faculty Office Hours Program and shifts this funding from the Proposition 98 Reversion Account to the permanent base budget.
- ◆ Capital Outlay – \$169.4 million for 66 continuing and three community college capital outlay projects at 56 campuses, including \$7.6 million in Proposition 1A Bond funds and \$161.8 million in proposed general obligation bond funding to be placed on the November 2002 ballot.
- ◆ Governor's Economic Stimulus Initiative – \$170.4 million to fast-track 11 additional California Community Colleges capital outlay pro-

jects to be funded from lease-revenue bonds as part of the Governor's Economic Stimulus Initiative.

- ◆ The governor also proposes a total of \$130.9 million in reductions for the California Community Colleges, including:
- ◆ CalWORKs – \$58 million reduction to CalWORKs programs based on the governor's view that the State has sufficient funds to meet the federal maintenance-of-effort requirement for federal Temporary Aid for Needy Families funds.
- ◆ Matriculation Activities – \$26.8 million reduction in matriculation related activities, such as student orientation, assessment and course counseling services.
- ◆ Fund for Student Success – \$10 million reduction from the Fund for Student Success, which provides short-term grants to student retention related activities.
- ◆ Telecommunications & Technology Infrastructure Program – \$19.8 million reduction in the telecommunications and technology infrastructure program used for training and local improvements.
- ◆ Economic Development/Nursing Programs – \$9.9 million reduction in economic development programs, including a \$1 million reduction of enrollment growth funding for nursing programs created pursuant to AB 87 (Hannah-Beth Jackson).
- ◆ Faculty & Staff Development – \$5.2 million reduction for all Community College faculty and staff development programs funded out of the statewide Chancellor's Office.
- ◆ State Operations – \$1.2 million reduction to eliminate 15.5 employee positions.

The California State University

- ◆ Base Increase – \$37.7 million increase in the State's base funding support, for a 1.5 % general fund increase.
- ◆ Student Fees – For the eighth consecutive year, the governor does not propose an increase in student fees, however, the governor also does not propose for the State to provide funding to continue the State's "buy-out" of a proposed student fee increase, creating a State savings of \$28 million.
- ◆ Enrollment Growth – \$78.1 million to fully fund enrollment growth by 4 % at 12,270 additional full-time equivalent students, including continued funding support for enrollment growth at ten CSU campuses during the summer term. In addition, the proposed budget provides \$1.1 million to fully fund year-round instruction at the Chico campus (240 FTES).

- ◆ Capital Outlay – \$258.8 million for 20 continuing capital outlay projects at 15 campuses and 10 new capital outlay projects at the nine existing campuses in proposed general obligation bond funding to be placed on the November 2002 ballot.
- ◆ Governor’s Economic Stimulus Initiative – \$191 million to fast-track three additional State University capital outlay projects to be funded from lease-revenue bonds as part of the Governor’s Economic Stimulus Initiative.
- ◆ The governor also proposes a total of \$89.8 million in reductions for CSU, including:
 - ◆ Energy Costs – \$20 million continuation of the governor’s proposed mid-year reduction related to lower energy costs.
 - ◆ Institutional Financial Aid Programs – \$14.5 million reduction in excess funds provided in prior years when fees were at a higher level.
 - ◆ Teacher Training – \$6.5 million reduction for the Educational Technology Professional Development Program.
 - ◆ Teacher Recruitment – \$5 million reduction for the Cal-Teach Teacher Recruitment Program.

University of California

- ◆ Base Increase – \$47.5 million increase in the State’s base funding support, for a 1.5 % general fund increase.
- ◆ Student Fees – For the eighth consecutive year, the governor does not propose an increase in student fees, however, the governor does not propose for the State to provide funding to continue the State’s “buy-out” of a proposed student fee increase, creating a State savings of \$36 million.
- ◆ Enrollment Growth – \$63.8 million to fully fund enrollment growth by 3.9 % at 7,100 additional full-time equivalent students, including continued funding support for enrollment growth at the Berkeley, Los Angeles and Santa Barbara campus during the summer term. In addition, the proposed budget provides \$8.4 million to fund, at the agreed-upon marginal cost of instruction, the full cost of existing summer enrollment (897 FTE) at the Davis campus and to “buy down” summer fees for new summer enrollments at the Irvine, Riverside, San Diego and Santa Cruz campuses.
- ◆ Capital Outlay – \$85.3 million for 14 new and five continuing capital outlay projects at the 9 existing campuses, including \$8 million in Proposition 1A Bond funds and \$74 million in proposed general obligation bond funding to be placed on the November 2002 ballot. In

addition, the Governor proposes shifting \$308 million for the California Institutes for Science and Innovation to lease-revenue bonds.

- ◆ Governor's Economic Stimulus Initiative – \$279 million to fast-track seven additional UC capital outlay projects, including \$16.5 million for the accelerated development of the UC Merced campus and \$66 million for the UC Davis Veterinary Medicine expansion, to be funded from lease-revenue bonds as part of the Governor's Economic Stimulus Initiative.
- ◆ UC Merced – In addition to funds for UC Merced capital outlay projects, the governor proposes to provide a \$4 million, one-time appropriation for faculty recruitment in time for the accelerated opening of the campus by fall 2004.
- ◆ The governor also proposes a total of \$102.5 million in reductions for the University, including:
 - ◆ K-12 Minority Outreach Programs – \$4.2 million reduction from K-12 outreach programs designed to increase diversity at the University.
 - ◆ Energy Costs – \$25 million continuation of the governor's proposed mid-year reduction related to lower energy costs.
 - ◆ Institutional Financial Aid Programs – \$17 million reduction in excess funds provided in prior years when fees were at a higher level.
 - ◆ Digital California Project – \$4.8 million reduction for the K-12 Internet2 program through the Digital California Project.
 - ◆ Teacher Training – \$4 million reduction in the California Subject Matter Projects and continuation of the proposed \$6 million reduction for the Governor's Professional Development Institutes reflecting a lower than expected demand for training of K-12 teachers.

California Student Aid Commission

- ◆ All Cal Grants – \$694.3 million for all types of Cal Grants, an increase of \$155 million, or 28 %, over the \$539.3 million budgeted in the current year, totaling a projected 33,325 new financial aid awards to needy students. The Cal Grant A maximum award is equal to the mandatory systemwide fees at UC or CSU and is estimated to be \$9,708 for students attending an AICCU institution.
- ◆ Assumption Program of Loans for Education (APLE) – The Budget includes a \$10.6 million General Fund increase to provide loan repayments to students who have already entered the teaching profession. The APLE program assumes up to \$19,000 in student loans for up to 6,500 students each year who agree to teach in underserved schools.

California Postsecondary Education Commission

- ◆ \$3.3 million in State General Funds, a 12.8 % decrease from 2001-02 funding levels. The reductions include \$315,000 from personnel, \$17,000 in general operating expenses, and the deletion of \$96,000 in one-time funding appropriated in 2001-02.
- ◆ \$150,000 in one-time funding for CPEC to prepare a survey of State outreach programs.
- ◆ \$14,000 for a portion of the funding required for the continuation of the Commission's Eligibility Study.

As is the case for most other General Fund State agencies in the 2002-03 budget, Governor Davis proposes that the Postsecondary Education Commission's personnel budget be reduced, by a certain amount – \$315,000 for the Commission as is noted above. As a comparison, the governor proposes that the California Community College Chancellor's Office – also a State agency – sustain a \$1.2 million reduction and the elimination of 15.5 positions. Similarly, the governor proposes that the Student Aid Commission's operating budget be reduced by \$258,000 in 2002-03.

Other government programs

Below are brief summaries of proposed funding levels and programmatic initiatives in several non-education sectors of the 2002-03 State budget.

Public Safety – \$8.2 billion is provided for various programs within the Youth and Adult Correctional Agency, Department of Justice, Office of Criminal Justice Planning, Commission on Peace Officer Standards and Training, Office of the Inspector General, and the California Highway Patrol. This is a 0.7 % increase over the revised 2001-02 spending in this category.

Health and Human Services – \$66.7 billion in combined State and federal funds (approximately \$21 billion from the State General Fund) for programs such as: Medi-Cal, Child Health and Disability Prevention, CalWORKS, Healthy Families, etc. Most of the major funding adjustments proposed in the budget are restorations of previously deleted funds, allocations of Proposition 99 ("Tobacco Tax") monies for public health initiatives, and utilizing various federal funds available for these programs.

Environment and Resources – \$5.2 billion for natural resources and environmental protection, including \$519.3 million for the State's share of CALFED-Bay Delta Program, \$32.1 million for the State Coastal Conservancy to protect the California shoreline, and \$243.6 million for the California Energy Commission's efforts to ensure a reliable supply of energy to meet California's needs, while complying with environmental, safety, and land use goals.

State and Local Assistance Programs – \$3.7 billion for full reimbursement to local governments for the vehicle license fee offset program, \$100.3 million for other public safety programs that benefit local governments, and the State's share of trial court funding costs, which frees up general-purpose revenues for counties to use on other priorities

Statewide Issues – In October, 2001 the governor's Executive Order D-49-01 directing State agencies to initiate various cost savings measures resulting in \$150 million in savings. In addition, the governor ordered a hiring freeze that is estimated to result in General Fund savings of up to \$13 million in 2001-02 and \$20 million in 2002-03. The Administration has negotiated Memoranda of Understanding with most of the Employee Collective Bargaining Units. The Budget includes \$64.3 million (\$41.8 million General Fund) in 2001-02 and \$209.7 million (\$130 million General Fund) in 2002-03 for employee compensation adjustments.

The Budget reflects a proposal to defer most of the State's and school's 2002-03 contributions to the California Public Employees' Retirement System in exchange for providing a higher level of purchasing power protection for State and school retirees. The agreement will result in a net General Fund reduction of \$371.4 million in 2002-03 and \$123.8 million in 2003-04.

Summary The proposed Governor's budget for the 2002-03 addresses many government program areas with the relatively limited funds currently available. Over the next six months, public policymakers for the State of California will have to address many complicated challenges as they seek to meet the public programs and services expectations of the State's 34 million residents. Even by year's end, the State's economy is not expected to produce government revenues sufficient to sustain current expenditure levels and may not be so positioned for at least one and one-half years.

As a mostly discretionary program in which the State can easily vary its spending levels, public postsecondary education is always in potential jeopardy during tight fiscal times. Very little of the nearly \$10 billion of State General Funds allocated to higher education is protected in law. However, the proposed budget contains only minimal cuts in higher education funding and provides year-to-year increases in overall funding levels. In this environment, the State must try to find creative ways to meet the educational needs of the more than 2.5 million Californians enrolled in its colleges and universities and plan to accommodate the tens of thousands of soon-to-be college students who will seek enrollment over the coming year.
